

Sector: IT & ITES

Result Update

	Change
Reco: Buy	↔
CMP: Rs. 831	
Price Target: Rs. 920	↑
↑ Upgrade ↔ No change ↓ Downgrade	

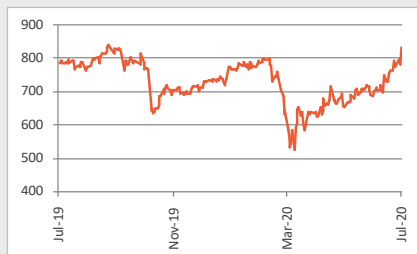
Company details

Market cap:	Rs. 354,127 cr
52-week high/low:	Rs.848 / 511
NSE volume: (No of shares)	99.3 lakh
BSE code:	500209
NSE code:	INFY
Sharekhan code:	INFY
Free float: (No of shares)	369.8 cr

Shareholding (%)

Promoters	13.2
FII	49.1
DII	24.7
Others	13.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	21.0	30.1	7.2	5.9
Relative to Sensex	10.8	9.6	20.0	12.4

Sharekhan Research, Bloomberg

Infosys reported better-than-expected results on all financial fronts despite supply-side constraints, with strong deal wins and free cash flow (FCF) generation. Constant currency (CC) revenue declined by 2% q-o-q, way above consensus estimates, led by limited impact of supply-side issues (10% of total revenue impact). Revenue increase on a y-o-y basis (1.5% CC) was driven by positive growth in hi-tech, life science, and financial services verticals. Further, digital CC revenue growth of 25.5% y-o-y aided growth. EBIT margin improved by 150 bps q-o-q to 22.7%, significantly exceeding our estimates, led by currency tailwinds (+70 bps), lower travel expenses (+230 bps), and lower SG&A expenses (+110 bps), which were partially offset by lower utilisation (-150 bps) and higher variable pay (-100 bps). Net profit of Rs. 4,233 crore was 9.9% ahead of our estimate, supported by higher operating margin. Surprisingly, management resumed guidance with annual revenue growth guidance of 0-2% in CC for FY2021E, while TCS's management expects flat CC revenue on y-o-y comparison by March 2021. Despite concerns relating to potential second wave of lockdown, the company expects positive growth in FY2021E because of its strong relationships with clients, traction for its digital offerings, higher localisation in the U.S., strong deal wins especially in the BFSI vertical, and healthy deal pipeline. Even as reduction of IT spending is expected during 2020, Infosys is well poised to gain share in the recessionary environment and outperform peers in terms of revenue growth in FY2021E.

Key positives

- TCV wins of \$1.7 billion in Q1FY2021, up 6% q-o-q
- EBIT margin at 22.7%, significantly exceeding our estimates
- Guided revenue growth of 0-2% and operating margin at 21-23% for FY2021E

Key negatives

- Continued softness in capital markets and payments segment
- Witnessing reduction in discretionary spending as clients' focus on preserving cash

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 920: We have revised our earnings estimates upwards for FY2021E/FY2022E, factoring in strong Q1FY2021 results and impressive annual guidance on both revenue and margin for FY2021E. We believe Infosys is well positioned to deliver strong growth in FY2022E because of pent-up demand, strong digital capabilities, and market share gains. At the CMP, the stock is trading at 21x/19x its FY2021E/FY2022E earnings estimates. Infosys is one of the industry leaders with robust execution capabilities and strong balance sheet (cash balance of \$3.8 billion, which is around 8% of current market capitalisation) with healthy FCF generation capability. Hence, we maintain our Buy rating on the stock with a revised PT of Rs. 920.

Key Risks

Rupee appreciation and/or adverse cross-currency movements, slackening pace in deal closures and/or constraints in local talent supply in the U.S. would have an adverse impact on its earnings.

Valuation	Rs cr				
Particulars	FY18	FY19	FY20	FY21E	FY22E
Revenue	70,522.0	82,675.0	90,791.0	97,366.0	107,255.8
OPM (%)	27.0	25.3	24.5	25.0	25.2
Adjusted PAT	14,597.0	15,856.0	16,594.0	17,026.2	18,925.2
% YoY growth	1.7	8.6	4.7	2.6	11.2
Adjusted EPS (Rs.)	32.4	35.4	39.0	40.1	44.6
P/E (x)	25.7	23.5	21.3	20.8	18.6
P/B (x)	2.9	2.9	2.9	2.9	2.8
EV/EBITDA (x)	17.2	15.7	15.0	13.6	12.2
RoNW (%)	23.9	23.7	25.4	25.9	28.5
RoCE (%)	30.2	32.2	32.3	33.5	37.9

Source: Company; Sharekhan estimates

Strong beat in tough times

Infosys reported better-than-expected results on all financial fronts with strong TCVs of large deals and FCF generation. The company's CC revenue declined by 2% q-o-q (way above consensus estimates) and increased by 1.5% y-o-y. Total revenue impact during the quarter was contributed by supply-side constraints (10% of total impact) and the remaining by demand side. Revenue increase on a y-o-y basis was driven by strong growth in hi-tech and life sciences vertical. Financial services vertical's revenue grew by 2.1% y-o-y on CC basis during the quarter. Further, digital CC revenue growth of 25.5% y-o-y aided growth. On a reported basis, USD revenue declined by 2.4% q-o-q to \$3,121 million. EBIT margin improved by 150 bps q-o-q to 22.7%, significantly exceeding our estimates. Margin improvement during the quarter was driven by currency tailwinds (+70 bps), lower travel expenses (+230 bps), and lower SG&A expenses (+110 bps), partially offset by lower utilisation (-150 bps) and higher variable pay (-100 bps). Net profit of Rs. 4,233 crore (-2% q-o-q, +11.5% y-o-y) was 9.9% ahead of our estimates, aided by strong improvement in operating margin.

Guidance reinstated; deal wins remains strong

Infosys' management resumed its annual revenue growth guidance despite concerns relating to potential second wave of infections in the view of COVID-19. Surprisingly, management has guided FY2021E revenue growth of 0-2% in CC, while TCS's management expects flat CC revenue on y-o-y comparison in Q4FY2021. Further, the company expects operating margin to remain at 21-23% (EBIT margin was 21.3% in FY2020). Even as reduction of IT spending is expected during 2020, Infosys is well positioned to gain share in the recessionary environment and outperform peers in terms of revenue growth. Management indicated faster recovery in volume and deal in financial services vertical especially in USA and APAC during the quarter, though it continues to see softness in capital market and payment sector. However, deal wins momentum remains strong across the vertical, given strong demand for digital transformation, cloud, work transformation, cost efficiency, automation, and cyber security. Given strong relationship with clients, superior digital capabilities, and strong local presence in key markets, Infosys is well positioned to deliver strong growth in FY2022E due to pent-up demand and market share gains.

Key result highlights from earnings call

- ♦ **Strong performance in multiple areas:** Infosys' Q1FY2021 results were strong across multiple dimensions such as strong digital revenue growth, large deal wins, healthy improvement in operating margin, strong cash collection, which led to health cash flows, and reduction in attrition.
- ♦ **Reinstated guidance:** Given strong Q1FY2021 results and strong client relationships, management has reinstated the annual guidance for both revenue and EBIT margin for FY2021. Management has provided FY2021E annual revenue growth guidance of 0-2% on CC and operating margin to be at 21-23%.
- ♦ **Strong growth in digital business:** Digital revenue grew by 25.5% y-o-y in CC as against 31.7% y-o-y growth in Q4FY2020. Digital business revenue contributes 44.5% to total revenue versus 41.9% in Q4FY2020. The increase in demand in data and analytics, cloud, security, cost efficiency, and IOT would continue to drive growth in digital.
- ♦ **Vertical performance:** Five out of eight verticals, i.e. hi-tech (up 13.4% CC y-o-y), life sciences (up 7.7% CC y-o-y), financial services (up 2.1% CC y-o-y), and others (24.4% CC y-o-y) reported positive revenue growth on a y-o-y basis during the quarter. While manufacturing (up 0.3% CC y-o-y), energy and utilities (-0.2% CC y-o-y), and communication (-0.7% CC y-o-y) reported muted growth on a y-o-y basis. Growth in financial services decelerated to 2.1% CC y-o-y in Q1FY2021 from 5.7% CC y-o-y in Q4FY2020, while the retail vertical's revenue declined to 7.4% CC y-o-y in Q1FY2021 from 4.2% CC y-o-y revenue growth in Q4FY2020. Revenue in energy and utilities vertical declined to 0.2% CC y-o-y in Q1FY2021 versus 7.3% CC y-o-y growth in Q4FY2020.
- ♦ **Large deal wins:** Infosys has signed 15 large deals during the quarter, with TCVs of \$1.74 billion (versus \$1.65 billion/\$2.7 billion in Q4FY2020/Q1FY2020). Out of 15 large deals, the company won five deals in financial services, three deals each in retail, energy and utilities, and hi-tech and one deal in manufacturing. Geography wise, the company signed 13 deals in North America and two deals in Europe. The share of new deals to overall TCVs stood at about 19% versus 66% in Q4FY2020.
- ♦ **Client metrics and strong growth in top account:** Infosys added 110 new clients during the quarter. The number of \$100 million clients dropped by three on a q-o-q basis to 25, while \$50 million clients declined by one on a q-o-q basis. The number of \$10 million increased by two q-o-q to 236. Revenue from large clients increased by 7.1% q-o-q during the quarter, while revenue from top 10 and top 25 clients remained flat on a q-o-q basis.
- ♦ **Lower impact of supply-side challenges:** Infosys helped clients to run their operations seamlessly by enabling remote work support. The company's supply enablement lowered the impact of COVID-19 compared to what was estimated at the beginning of the year.
- ♦ **Lower utilisation:** Utilisation dropped sequentially during the quarter to 81.2% from 83.5% in Q4FY2020, primarily owing to supply-side constraints in view of COVID-19. Onsite utilisation remained steady during the quarter despite drop in the beginning of the quarter.
- ♦ **Attrition rate:** Attrition rate was down to 11.7% versus 18.2% in Q4FY2020. There is significant improvement in the attrition rate during the quarter. This is significantly lower compared to its comfortable band of 13-14%.
- ♦ **Strong balance sheet and cash flows:** Infosys had cash balance of \$3.8 billion with no debt. Increased focus on cash collections resulted in \$728 million of FCF during the quarter. FCF grew by 22.8% q-o-q and 50.1% y-o-y during the quarter.
- ♦ **Higher localisation helped mitigate risks:** Infosys' early investments in localisation initiatives in the U.S. helped the company to minimise supply-side issues during the period of travel restrictions. As majority workforce in the U.S. is local, it helped the company to better manage the evolving visa regulations in the U.S.

Results

	Rs cr				
Particulars	Q1FY21	Q1FY20	Q4FY20	y-o-y (%)	q-o-q (%)
Revenue (\$ mn)	3,121.0	3,131.0	3,197.0	-0.3	-2.4
Net sales	23,665.0	21,803.0	23,267.0	8.5	1.7
Direct costs	14,947.0	14,098.0	14,752.0	6.0	1.3
Gross profit	8,718.0	7,705.0	8,515.0	13.1	2.4
SG&A	2,597.0	2,553.0	2,839.0	1.7	-8.5
EBITDA	6,121.0	5,152.0	5,676.0	18.8	7.8
Depreciation & amortisation	756.0	681.0	749.0	11.0	0.9
EBIT	5,365.0	4,471.0	4,927.0	20.0	8.9
Other income	427.0	696.0	569.0	-38.6	-25.0
PBT	5,792.0	5,167.0	5,496.0	12.1	5.4
Tax provision	1,520.0	1,365.0	1,161.0	11.4	30.9
Reported net profit	4,233.0	3,802.0	4,321.0	11.3	-2.0
Adjusted net profit	4,233.0	3,802.0	4,321.0	11.3	-2.0
EPS (Rs.)	10.0	8.8	10.2	13.0	-2.1
Margin (%)				bps	bps
EBITDA	25.9	23.6	24.4	224	147
EBIT	22.7	20.5	21.2	216	149
NPM	17.9	17.4	18.6	45	(68)

Source: Company; Sharekhan Research

Revenue mix: Geographies, industry verticals and other operating metrics

Particulars	Revenues	Contribution	\$ Growth (%)		CC growth (%)	
	(\$ mn)	(%)	q-o-q	y-o-y	q-o-q	
Revenue (\$ mn)	3,121	100	-2.4	-0.3	1.5	
Geographic mix						
North America	1,919	61.5	-2.5	-0.5	0.0	
Europe	749	24.0	-4.0	1.4	4.4	
India	91	2.9	8.9	25.7	32.8	
Rest of world	362	11.6	-0.7	-7.5	-2.0	
Industry verticals						
Financial services	983	31.5	-1.8	0.0	2.1	
Retail	446	14.3	-9.9	2.6	-7.4	
Communication	418	13.4	0.6	-0.1	-0.7	
Energy, utilities, resources & services	399	12.8	-3.1	5.4	-0.2	
Manufacturing	296	9.5	-8.2	5.8	0.3	
Hi tech	272	8.7	7.5	7.3	13.4	
Life sciences	209	6.7	2.2	9.5	7.7	
Others	97	3.1	4.4	18.8	24.4	
Service line						
Digital	1,389	44.5	3.6	24.1	25.5	
Core	1,732	55.5	-6.7	-13.9	-11.8	
Clients Contribution						
Top client	106	3.4	7.1	5.9		
Top 10 clients	602	19.3	0.8	-3.8		
Top 25 clients	1,080	34.6	-0.9	-1.2		
Revenue per employee						
Revenue per FTE (\$ K)	53.5	-	0.0	0.0		
Deal wins (\$ mn)						
TCV	1,744	-	6.0	-35.7		

Source: Company; Sharekhan Research

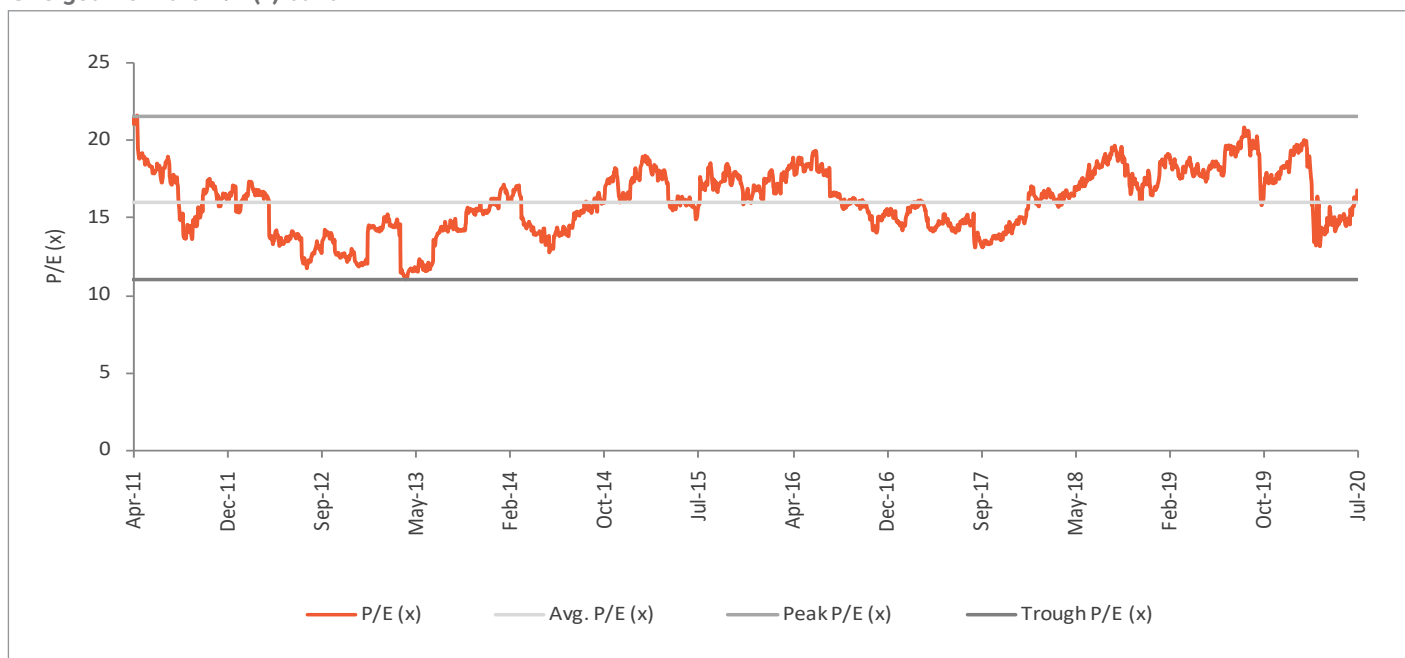
Outlook

The COVID-19 outbreak is causing supply disruption and will lead to material deterioration of the demand environment and cut in discretionary spending, request for rate concession, and postponement of large deal wins. However, Infosys provides services to a large number of Fortune 500/Global 500 clients and these have a strong balance sheet and are able to hold on better in the economic downturn. Further, Infosys has aggressively invested in digital technologies in the past couple of years to capture the large portion of upcoming digital spends. Given strong relationships with clients and robust execution capabilities, Infosys is well positioned to capitalise on opportunities as and when clients boost their technology spends. The company has surprised us with providing annual revenue growth guidance of 0-2% for FY2021E despite forecast of decline in IT services spends worldwide in 2020.

Valuation

Best performance among peers: We have revised our earnings estimates upwards for FY2021E/FY2022E, factoring in strong Q1FY2021 results and impressive annual guidance on both revenue and margin fronts for FY2021E. We believe Infosys is well positioned to deliver strong growth in FY2022E because of pent-up demand, strong digital capabilities, and market share gains. At the CMP, the stock is trading at 21x/19x its FY2021E/FY2022E earnings estimates. Infosys is one of the industry leaders with robust execution capabilities and strong balance sheet (cash balance of \$3.8 billion, which is around 8% of current market capitalisation) with healthy FCF generation capability. Hence, we maintain our Buy rating on the stock with a revised PT of Rs. 920.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer comparison

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBIDTA (x)		P/BV (x)		RoE (%)	
				FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
HCL Tech	615	271	166,945	16.9	14.6	5.1	4.6	3.0	2.7	18.4	19.4
TCS	2,234	375	838,114	27.9	24.6	20.4	18.4	10.1	9.9	35.9	40.6
Wipro	263	570	150,261	16.4	15.0	4.5	3.9	2.6	2.4	13.9	14.0
Infosys	831	424	354,127	20.8	18.6	13.6	12.2	2.9	2.8	25.9	28.5

Source: Company, Sharekhan estimates

About company

Founded in 1981, Infosys is the second largest (\$12,780 million in FY2020) IT services company in India in terms of export revenue with 2.25 lakh number of head count. BFSI accounts for the largest chunk of revenue (~31.5% of total revenue), followed by retail, energy and utilities, and manufacturing. Region wise, North America and Europe continue to be the mainstay. Digital revenue continued to have strong growth momentum in the past few quarters and now contributes 40.6% to total revenue.

Investment theme

Infosys has accelerated deal wins momentum through engagement with deal advisors, consulting firms, and private equity players. Effectively, the strong large deal trajectory provides better revenue growth visibility. Further, revitalisation of sales and investment in digital competencies have certainly helped the company to drive its digital business. Sharp focus on execution and augmentation of digital capabilities through investments can bring Infosys back on its high-growth trajectory. Given strong deal wins, strengthening relationships with large clients, and continued digital momentum, we believe Infosys is well positioned to catch up with leaders on revenue growth in the coming years.

Key Risks

1) Regulatory visa norms could have an impact on employee expenses; 2) Any instability in leadership; additional exits at senior management level; 3) Rupee appreciation and/or adverse cross-currency movements; and 4) increasing attrition rate.

Additional Data

Key management personnel

Nandan M. Nilekani	Co-founder and Non-Executive Chairman
Salil Parekh	Chief Executive Officer
U.B. Pravin Rao	Chief Operating Officer (COO)
Nilanjan Roy	Chief Financial Officer
Ravi Kumar S	President, Deputy COO
Mohit Joshi	President, Head – BFSI & HCLS

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Deutsche Bank Trust Co Americas	17.36
2	Life Insurance Corp of India	6.62
3	BlackRock Inc	4.55
4	Vanguard Group Inc/The	3.02
5	SBI Funds Management Pvt Ltd	2.56
6	HDFC Asset Management Co Ltd	2.09
7	ICICI Prudential Asset Management	2.03
8	Republic of Singapore	1.64
9	ICICI Prudential Life Insurance Co	1.54
10	UTI Asset Management Co Ltd	1.22

Source: Bloomberg

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